THE NINTH COLIN CLARK
MEMORIAL LECTURE 1999

ECONOMIC NATIONALISM AND PERFORMANCE: AUSTRALIA FROM THE 1960s TO THE 1990s

by

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Ted Evans

Secretary to the Treasury

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I acknowledge the assistance of Treasury colleagues in the preparation of this paper, particularly Terry O'Brien for the original thoughts and research.

PREFACE

The Lecture

This is the paper presented by Mr Ted Evans as the Ninth Colin Clark memorial lecture of The University of Queensland was jointly organised in association with the Department of Economics, The University of Queensland, The University of Queensland Economics Alumni Association and The Economic Society of Australia (Qld) Inc). The Colin Clark Lecture should relate to at least one of the many areas of applied economicsto which Dr Colin Clark contributed during his lifetime.

Colin Grant CLARK (1905-1989) MA *Oxf. & Camb.*, HonDEcon *Tilburg*, DLitt *Oxf.*, HonDSc *Milan*, HonDEcon, FBA, was described by Professor H.W. Arndt as having "... one of the most fertile minds in twentieth century applied economics".

Born in England, Colin Clark graduated in chemistry at Oxford University in 1924, and subsequently studied at Cambridge University. Initially he worked as an assistant to William Beveridge and Allyn Young. After unsuccessfully seeking election to the House of Commons in 1929 as a Labour candidate, he joined the staff of the Economic Advisory Council, of which Keynes was a member. In 1931 he was appointed Lecturer in Statistics at Cambridge where he stayed until 1937. In 1937 he went to the University of Melbourne as a visiting lecturer. In Australia he mainly occupied government posts, chiefly as economic adviser to the Queensland Government until 1952. He subsequently held posts at the University of Chicago and Oxford University. He was Director of the Oxford Institute of Agricultural Economics until 1968, when he returned to Australia. In 1987 Clark was one of the first recipients, with Professor Trevor Swan, of the Distinguished Fellow awards, presented by The Economic Society of Australia. Until his death in 1989, he was Honorary Research Consultant in the Department of Economics at The University of Queensland.

Colin Clark's works span a wide spectrum of economic issues. He was one of the pioneers of national income estimates in the 1930s, and has been described as co-author, with Simon Kuznets, of "the statistical revolution" that accompanied the revolution in macroeconomics. He made some of the first estimates of Keynes' multiplier, and in 1937 published the first international comparisons of real national product. His *Conditions of Economic Progress* (1940) sparked a still continuing interest in secular growth and economic development, as well as providing the first statistical evidence of the gulf in living standards between rich and poor countries.

Later work focused on, *inter alia*, food supply, population, irrigation, subsistence agriculture, public finance, economic growth, and agricultural productivity in developing countries.

The Lecturer

Following a decade working in telecommunications with what was then the Postmaster General's Department, Ted Evans graduated from the University of Queensland in 1969 with Honours in Economics and joined the Australian Treasury. From 1969 to 1975 he was involved in a variety of research and policy advising on domestic economic matters, primarily on the macroeconomic side. For three years from 1976 he was a member of the Australian Permanent Delegation to the OECD in Paris. Returning to Australia in 1979, he was promoted within Treasury to the Senior Executive Service in 1980 as head of the Fiscal and Monetary Policy Branch and, in 1982, to head of the General Financial and Economic Policy Division. From 1984 to 1989 he held the position of Deputy Secretary and was heavily involved in taxation and microeconomic reform.

He joined the Board of the International Monetary Fund in 1989 as Executive Director representing Australia and a number of other countries, mainly in the Asia Pacific region.

He returned to Australia in May 1993 to assume the position of Secretary to the Treasury.

The Chair

The Chair for this lecture was Professor John Foster BA(Cov), MA(Econ) (Manc), PhD (Manc), Head, Department of Economics, The University of Queensland.

The Vote of Thanks

The vote of thanks was given by Carolyn Grainger, President of The Economic Society of Australia (Qld) Inc.

ECONOMIC NATIONALISM AND PERFORMANCE:
AUSTRALIA FROM THE 1960s TO THE 1990s

Ted Evans

Introduction

Ladies and gentleman, thank you for the opportunity to present the ninth Colin Clark Memorial Lecture, organised jointly by the University of Queensland and the Economic Society of Queensland.

Let us imagine that we are lunching here today in part on the Economic Society's profit from Colin's mischievous chairing, in 1981, of the Libyan-backed international conference on the theme "The Economic Basis of Colonel Muammar Al Qathafi's 'Third Universal Theory'".[1] That theme prompts a reminder of one of Colin Clark's penetrating assessments:

> "There is room for two or three economic theorists in each generation, not more. ... The rest of us should be economic scientists, content steadily to lay stone on stone in building the structure of ordered knowledge."[2]

Colin Clark did not rank himself as a theorist, but the *New Palgrave Dictionary of Economics,* which I can perhaps describe to non-economists in the audience as "the economist's 'Encyclopaedia Britannica'", rightly counts him as one of the most fertile minds in 20th-century applied economics.

He co-founded the modern framework of national accounting, applied it to contemporary empirical research, and experimented with its application to macroeconomic modelling. His *Conditions of Economic Progress* (1940) triggered the revival of interest in the causes of differences in economic performance across countries and time.

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1 This tribute to Colin Clarke's sense of the absurd is recounted at p 333 of *Colin Clark, 1905 - 1989: An Affectionate Memoir*, by Perkins, J.O.N. and A.A. Powell, the Economic Record, Vol 66 1990, pp 329-341

2 *Conditions of Economic Progress*, Macmillan, London, 1940 cited in ibid, p 330

Colin Clark was a gadfly, "stubbornly defending the free trade position" throughout a career dating back to his departure in 1930, in defence of that principle, from the Economic Advisory Council to UK Prime Minister Ramsay MacDonald (on which he had served with Keynes).[3] Much later in his career, he courageously disputed the "population bomb" theorists whose extrapolations were fundamentally non-economic in their refusal to think in terms of elasticities and the dynamics of disequilibria, and to acknowledge both the human capacity to learn and the responsiveness of human action to incentives.

In a professional career spanning more than half a century, he held prestigious appointments at the Universities of Oxford and Cambridge and the Institute for Policy Studies in the United Kingdom; the University of Chicago in America, and at the Universities of Melbourne, Monash and Queensland. He was Financial Adviser to the Queensland State Treasury from 1938 to 1952.

One of my predecessors as Secretary to the Commonwealth Treasury, the late Chris Higgins, recorded an extended interview with Colin Clark in 1988, the year before Colin's death.[4] I like to think that that interview remains one of the best windows on the intellectual vigour, breadth of vision, human warmth and tremendous curiosity that drove more than 50 years of top-flight economic work. The same gifts, I might note, were evident in Chris Higgins whose own significant contribution to economic policy advising grew from the same building blocks as Colin Clark's.

Overview

Today, I would like to join Clark's crusade in "stubbornly defending the free trade position", though on the slightly broader playing field of "economic nationalism". I shall not attempt precision in a definition of that latter term: suffice to say that I wish to address policies based

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3 'Stubbornly Defending the Free Trade Position' was Colin Clark's summary of his own stance, and formed the title of a commemorative essay by Heinz Arndt in Quadrant, November 1992, Volume 36 No 11 pp 57-62.

4 The interviews were published in 1989. See *Colin Clark: An Interview*, Christopher I Higgins, Economic Record Vol 65, pp 296-310.

on protection or preference for Australian resources and capital; for example, tariffs, quotas, marketing arrangements and increased restrictions on foreign investment.

Were I to put such a proposition "south of the border", I would be accused by many of fighting the last war – such policies, it would be said, are already in retreat. Perhaps so. But here in Queensland, my State of Origin, recent years have seen a resurgence of popular support – not government support – for such policies as people seek to grapple with the disruptions that inevitably accompany economic change.

Many might also see more irony in such suggestions arising at the very time that we are beginning to see the fruits of a decade or so's application of more outward looking policies. The national accounts data for the first quarter of 1999, published this week, confirm that Australia has continued to grow at over 4 per cent, as it has done throughout the so-called Asian financial crisis.

The contrast with the countries of Asia – and much of the rest of the world – not to mention our own post-war history, could not be more stark; and we should not miss the opportunity to objectively study the reasons and to learn the lessons.

Much of that has now been done, though the focus has been primarily on policies and performance no further back than the 1980s.[5]

I would like today to look back further, at some aspects of the past 40 years. I want to highlight the role of increased competition in Australia over that timeframe, and particularly increased *international* competition. That increase has served as a spur to lifting national economic performance towards global best practice by focussing our investment on the things we do best, and providing the incentives to actually do them well.

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[5] See for example *Economic Policy Reform and Australia's Recent Economic Performance*, Statement 3 in Budget Paper No 1, Budget Strategy and Outlook 1999-2000, or the speech by RBA Governor Ian Macfarlane to the CLSA Investors' Forum in Hong Kong on 21 May 1999, available at http://www.rba.gov.au.

We pursue economic policy, and economic reform, primarily to generate higher living standards. But our experience suggests that the policies which achieve that central objective best are those that also make the economy more flexible, and more capable of adapting smoothly and with minimum disruption to economic shocks.

Economic shocks can be regarded as the "stress tests" of economic policies and institutions. How well an economy performs in the wake of adverse shocks such as droughts, commodity price fluctuations or disruptions to the global economy is a test of its flexibility and the quality of its policy frameworks.[6] We can regard the Asian crisis as the stress test of the policies of the 1980s and 1990s, just as the oil price crises of he mid and late 1970s can be regarded as the stress test of the policies of the 1960s and 1970s.

To avoid a serious domestic downturn in the wake of an adverse international shock is a very important social achievement – an important contribution to the ultimate objective of improving living standards.

I suggest that Australia's comparative growth performance and resilience to shocks have been worst when currents of economic nationalism were at their peak in the late 1960s and through the 1970s. This was true even when inflation was low and the growth environment was fairly stable, in the 1960s. Comparative performance deteriorated even further when investment misallocations were compounded in the 1970s by high inflation and high nominal interest rates.

Comparison of present policies and performance with those of the 1960s and 1970s warrants a conclusion that Australia has weathered the Asian storm well because we are now more outward looking. We perform closer to world's best practice, within a stable macroeconomic policy framework that facilitates sound investments in a low inflation, low interest rate, stable growth environment.

Let's look at some of the facts, the longer term issues, to which I referred.

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6 Treasury has reviewed the volatility of various contributors to economic fluctuations dating back to the 1960s, and presented longer term evidence that Australia's economic resilience in the face of shocks has increased. See *The Business Cycle - Developments in the Economy's Response to Disturbances*, Economic Roundup, summer 1998, pp 45-67.

Firstly, the overall performance – most readily measured by GDP/capita comparisons of Australia and the OECD as is done in Chart 1. We can see that while Australia's average growth rate over the recoveries of the last four decades rose or fell with the growth rates for the OECD as a whole, only in the current decade has Australia's growth exceeded the OECD average.

Protection

Looking back at the 1960s and 1970s, one striking structural policy difference to the present day was our higher levels of protection and the still-widening disparity of protection over those decades. This was one expression of a prevailing economic nationalism, a concern that we couldn't compete with the world at large on our own merits, and a worry about "where the jobs would come from" if not from the continuation of high protection to labour-intensive manufacturing industries.

The best picture of the wide variations in the pattern of protection across the structure of Australian industry come from the calculations by the various antecedents to the Productivity Commission.[7]

They show that for the manufacturing sector, average effective rates of assistance were lowered gradually starting with the 25 per cent across-the-board tariff cut in July 1973. But through the 1960s and 1970s, the manufacturing average remained more than twice the average for the agricultural sector, while the average for the mining sector was actually negative.[8] (Chart 2)

More disturbingly, the estimates show that the dispersion of effective rates of assistance within the manufacturing sector actually continued to widen until the early 1980s. In the

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7 Most of the calculations were published by the Industries Assistance Commission, successor to the Tariff Board and predecessor to the Industries Commission and the current Productivity Commission.

8 Effective rates of assistance for the mining industry were calculated for only a few years starting in the early 1980s, so numbers can not be strictly compared with the longer series of estimates available for the manufacturing and agricultural sectors. However in 1983-84, the average effective rate of assistance for the mining sector was estimated to be minus 3.5 per cent.

economic stresses following the oil price shock and the 25 per cent across-the-board tariff cut, industries such as passenger motor vehicles and textiles, clothing and footwear received higher protection by quota. So the incentives to invest most in what we did worst, actually grew. (Chart 3)

It is now well established that such protection did little, if anything, for employment in the protected industries and was quite detrimental to employment in Australia as a whole.[9] For example, effective protection to the PMV and TCF industries more than doubled through the 1970s while employment in those industries fell. My focus today, however, is more on the detrimental effects of those policies on investment and I'll return to that in a moment.

The enchantment with protectionist policies, of course was deeply entrenched. Colin Clark, in speaking to Chris Higgins about his time (1938-1952) as a financial adviser to the Queensland Treasury, noted:

> "There was also an Industries Assistance Committee which used to guarantee loans to unsuccessful businesses. The Premier himself didn't think very much of it; he said we get all the applications that the banks have refused. ......

He went on:

> "My father used to think that Queensland needed protection against New South Wales. Keynes had a real blind spot on protectionism. He enjoyed being on the popular side."[10]

Plus ça change, ...

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9 See, for example, [Pearce, D. and A. Stoeckel, *One Shoe Per Person*, Centre for International Economics, Canberra, 1996].

10 See *Colin Clark: An Interview*, Christopher I Higgins, op cit, pp 303, 305.

Foreign investment policy

Another factor limiting efficiency in the allocation and management of investment from the late 1960s to the mid-1980s was our temporarily more restrictive foreign investment policy.

It is impossible to quantify the restrictiveness of foreign investment policy. Restrictiveness can not be measured by the number of foreign investment proposal rejected, or even by variations in the number of proposals received. The key, unmeasurable, dimension is the value of investments that might have been received, but instead went to other countries or "stayed at home" without ever formally registering an interest in Australia as a destination.

Given these difficulties of quantification, the best qualitative sense of restrictiveness in policy can be gained by studying the ebb and flow in foreign investment legislation, and the decisions which have made the policy more restrictive, and those which have relaxed it. This process is imprecise, but I am heartened that both academics and Treasury administrators of the foreign investment policy have independently arrived at essentially the same assessment. Foreign investment policy is consistently judged to have been more restrictive on business investment between the mid-1960s to the mid-1980s than either before or since.[11] (Chart 4)

Even more directly than the high level and increased dispersion of protection, this restrictive era in foreign investment policy was an expression of heightened economic nationalism, and a belief that foreign investments meant loss of sovereignty, and foreign takeovers meant loss of jobs.

In fact, the evidence is universally to the contrary: direct foreign investment is a particularly stable form of capital inflow. Even where foreign investment brings about modernisation that costs some employment directly (as it often will), it brings with it large benefits to competitiveness through exposing local management to international standards and best practices, and through technological benefits associated with the establishment of new

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11 Chart 4 shows an impressionistic representation by Treasury of the direction and approximate relative importance of variations in foreign investment policy. Essentially the same judgements are reported in *The MAI Affair: A Story and its Lessons*, by David Henderson, Pelham Papers No 5, Melbourne Business School, Melbourne 1999, pp 21-23. This essay also cites the similar assessments of Heinz Arndt; Snape, Gropp and Luttrell; and Lawrence Krause.

investments or the modernisation of old ones. Accordingly, the economy emerges better able to provide high-productivity, well paid jobs into the future.

The recent events in Asia remind us that debt is a very poor substitute for direct foreign investment – leaving countries dangerously exposed to the quality of their own policies and the associated whims of the financial markets.

It is a fact that, for all of its modern history, Australia has borrowed from abroad – our prosperity has been built on foreign investment. Foreign investment, properly managed, has a rightful role in our economy. However, if we are to maximise our growth opportunities we will need to do two things: improve our saving performance and improve our investment performance.

Much has been said about saving. What does history say about the second issue – our investment performance?

It is here, I believe, that we see most starkly the results of inward looking policies – economic nationalism.

Investment performance: the consequence of barriers to trade and foreign investment

On top of the trade and investment distortions, to which I have been referring, which peaked in the 1960s and 1970s, productive investment decisions were further complicated in the mid 1970s with the high rates of growth of Commonwealth expenditure, the acceleration of inflation and high nominal interest rates. Centralised wage fixing processes also worked to impose substantially uniform patterns of wage increase over wide areas of industry, again working to weaken pressures on employers to compete and to contain costs.

One could hypothesise that, with weak foreign competitive pressures and with only the agricultural and mining sectors largely exposed to international competition, investment flows would be inefficiently allocated. Compared to a more competitive environment, the import-substituting manufacturing sector would be larger, the agriculture, mining and international tradeable services sectors would be smaller, and the exchange rate would be higher. Within the manufacturing sector, investment flows would be further distorted towards the internationally uncompetitive industries whose rates of effective protection were falling most slowly, and away from the less uncompetitive industries whose protection rates were falling faster.

Colin Clark would have asked: how can we test such hypotheses? Where would we expect to see the consequences of such a pattern of resource mis-allocation?

Australian GDP growth relative to the growth rates of more open economies might be one indicator. Resilience of GDP growth to external shocks might be another (since one would expect less competitive economies to react slower to shocks, and to suffer larger and more protracted symptoms of disequilibrium such as persistent high unemployment than more flexible economies). And we have seen earlier that Australia's earlier GDP growth performance relative to other OECD economies was certainly not earth-shattering, even in the reputedly golden era of the 1960s.

But a more direct measure of the efficiency with which capital was used might be productivity performance and, most directly, capital productivity.

Here I divert briefly to note that this again is a family of measurement tools whose origination we owe to Colin Clark. Not only was he the co-founder of modern national accounting, but of the productivity measures implicit in those accounts.[12]

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12 "Keynes was very pleased with some of the work I did [in 1930] for the Economic Advisory Council [of Prime Minister Ramsay MacDonald, on the topic of product per man year]. It is now seen as an elementary idea, but in those days it was novel to compare the index of production, bad though it was, with the index of employment. This showed that that a moderate improvement in productivity had taken place in the 1920s which surprised all the other economists on the Advisory Council. It was a time of deep pessimism and they assumed that Britain had never got back to 1914 productivity levels; just an assumption, they had not examined the evidence." Christopher I. Higgins, *op.cit.*, p 298.

The Australian Bureau of Statistics has recently completed a far-reaching upgrade of its treatment of market sector capital stocks in the Australian National Accounts, in part to bring the treatment into conformity with the most recent international standard, the *System of National Accounts 1993*. The upgrade achieves a more realistic definition of capital assets, a better treatment of fast depreciating assets such as computers and software, and certain technical and conceptual improvements which need not detain us today.[13] The upgrade is in a sense incomplete, in that there is more work to be done to improve the empirical foundation for the treatments of asset lives and depreciation, and corresponding improvement to be made in the treatment of changes in the quality of labour in the labour productivity series. So the Statistician calls the new series "experimental", but firmly believes the new estimates are significantly better than those previously published.

Here is the result. The new capital stock series suggests that capital productivity actually declined by 30 per cent from the origin of the estimates in 1964-65 to the mid 1980s, before recovering very slightly since then. Before the revised method, capital productivity had been thought to have been essentially flat.[14] (Chart 5)

With all due allowance for measurement uncertainties, this is a truly remarkable performance. Bear in mind that we are talking about a modern economy only 200 years old, a net capital importer from the rest of the world, located among the world's fastest growing economies, with generous natural resources, a well-educated population, and with open agriculture and mining sectors where technologies and technical efficiency were presumably fairly close to good, if not best, practice.

Yet with each year's addition to the capital stock from new investment, the productivity of the entire capital stock declined!

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13 Australian Bureau of Statistics, *Australian System of National Accounts 1997-98*, Catalogue number 5204.2, feature article "Upgrade of Capital Stock and Multisector Productivity Estimates", pp 8-18

14 Estimates of labour productivity remain essentially unchanged in the new estimates, and multifactor productivity is lowered slightly in consequence mainly of the changes to the capital productivity series. As reported in the budget documentation, the new multifactor productivity series over the 1990s cycle shows an appreciable increase over the cycles of the 1970s and the 1980s. See *Budget Strategy and Outlook 1999-2000*, Budget Paper No 1, Statement 3: Economic Policy Reform and Australia's Recent Economic Performance, Chart 5 p 3-17.

This looks like very serious resource misallocation indeed. Perhaps the new numbers for the mid-1960s to the mid 1980s are "too bad to be true", and further work will moderate the historical gloom. But there seems little doubt we are now working with better statistical estimates of these phenomena than we had before.

So looking back to these earlier periods of ascendant economic nationalism, we see an irony: a concern that the rest of the world threatened us, and use of expansive domestic spending in response to external shocks, actually produced a worsening of economic and social outcomes, including the creation of persistent high unemployment that has still not been fully unwound. The allocation of investment was seriously distorted. The growth rate of GDP per employee slipped behind the OECD average, and while other OECD economies closed their per capita GDP gaps relative to the then leader, the US, Australia slipped down the per capita GDP rankings.[15]

Concluding remarks

The foregoing comments suggest good cause for confidence in the performance of the outward looking policies that Australia has pursued in the 1980s and 1990s, but lacked in the 1960s and 1970s.

The results are most evident in the improved performance of our capital stock, a result that reflects better price signals coming from better policies.

Of course there is more to be done. Even without further challenges, new external shocks, there are aspects of our performance that can obviously be improved.

But there will be new challenges: we are now more exposed than ever before to overseas economic influences, and the essence of our recent success is greater flexibility and competitiveness to global standards in an ever widening range of economic activities.

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15 *The Australian Economy: a View from the North*, R.E. Caves and L. B. Krause, eds., the Brookings Institution, George Allen & Unwin 1984, pp 4-6.

Strengths in competitiveness are intrinsically less than permanent: they require continuous vigilance and re-examination against the best of the world's policies, industries and institutions.

That can best be achieved by an open, self-confident scrutiny of the rest of the world's best practices, and exposure to them through international competition. We tried the alternative, economic nationalist route in the 1960s and the 1970s. It failed the stress test.

Chart 1:
Australian and OECD Per Capita Growth rates by decades

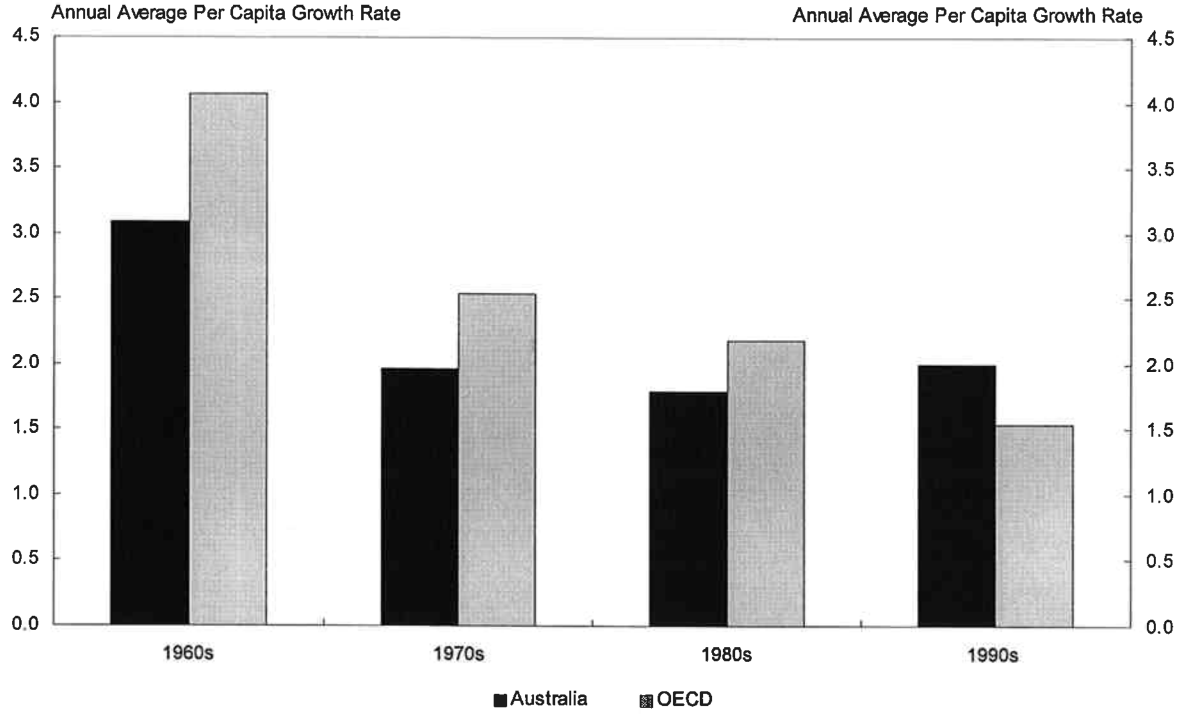


Chart 2
Assistance to Australian manufacturing and agriculture – Effective Rates of Assistance

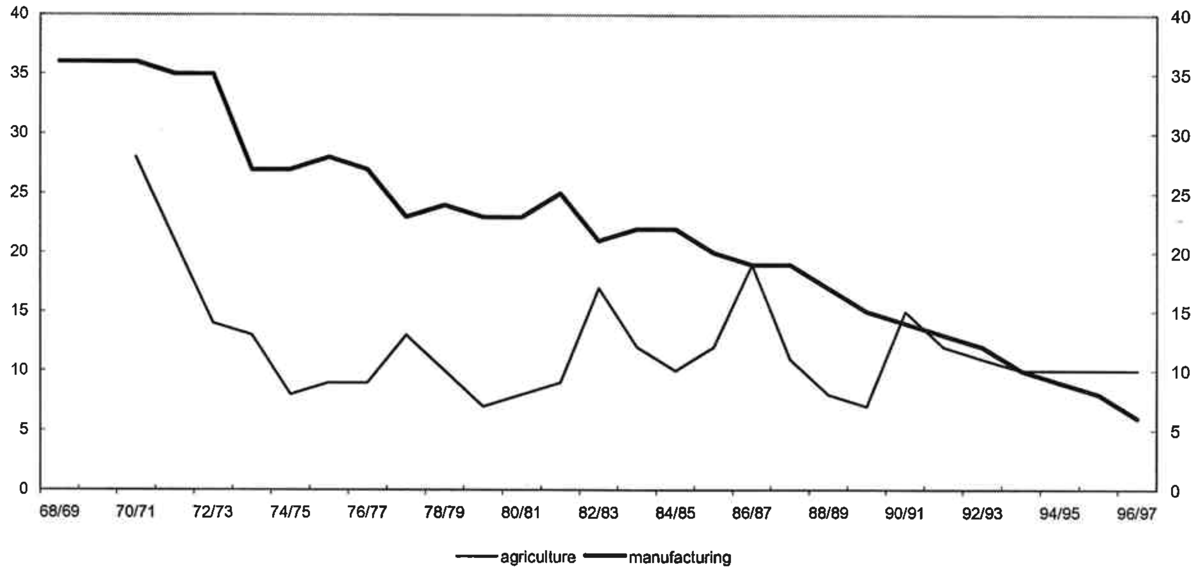


Chart 3
Standard deviations of manufacturing and agriculture effective rates of assistance

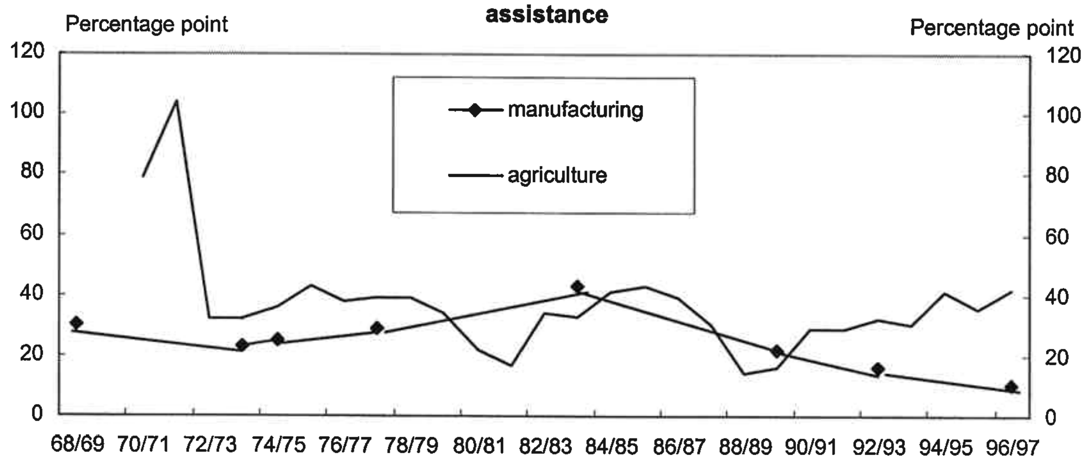


Chart 4: Direction of Foreign Investment Policy Changes

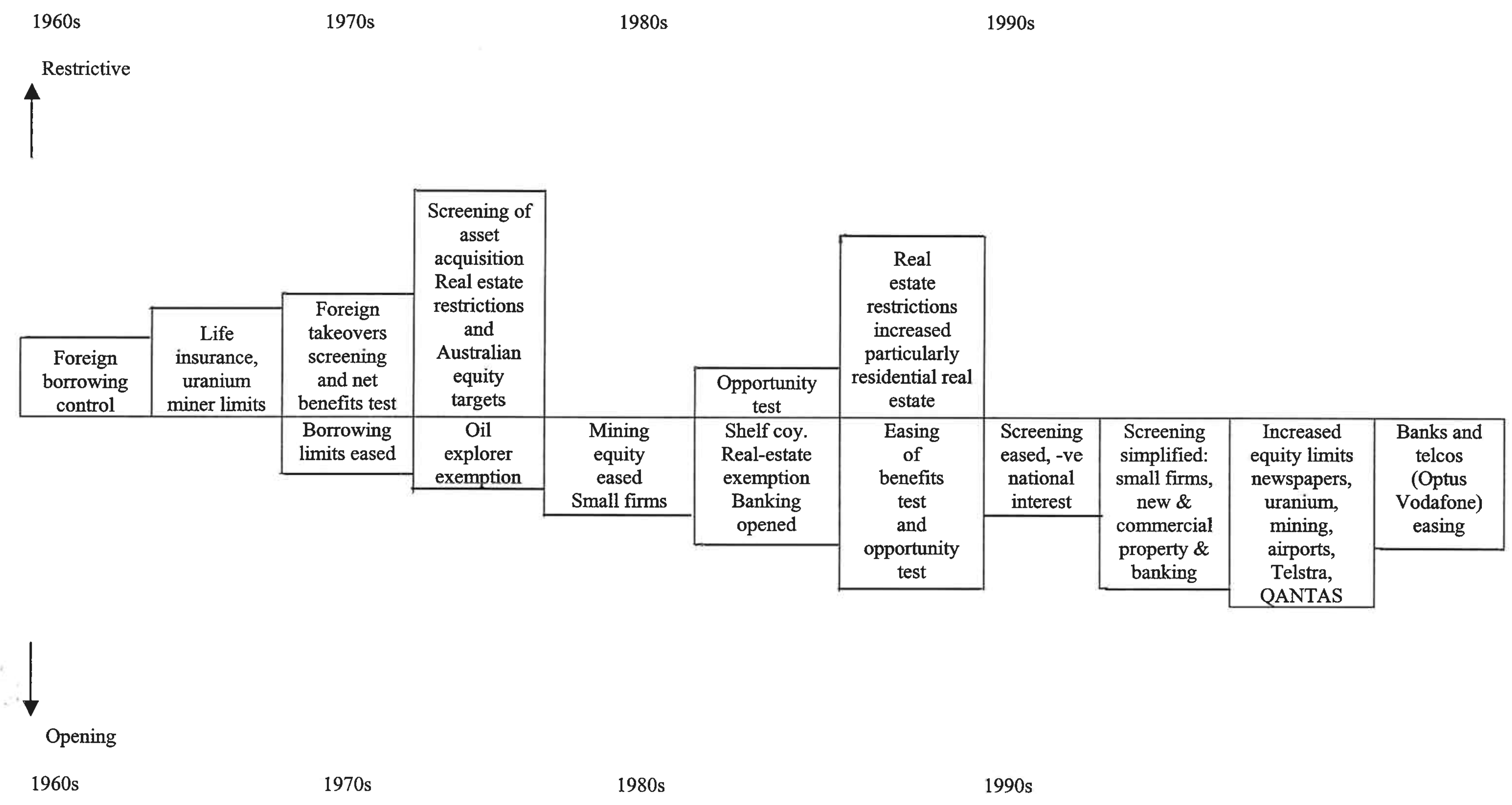
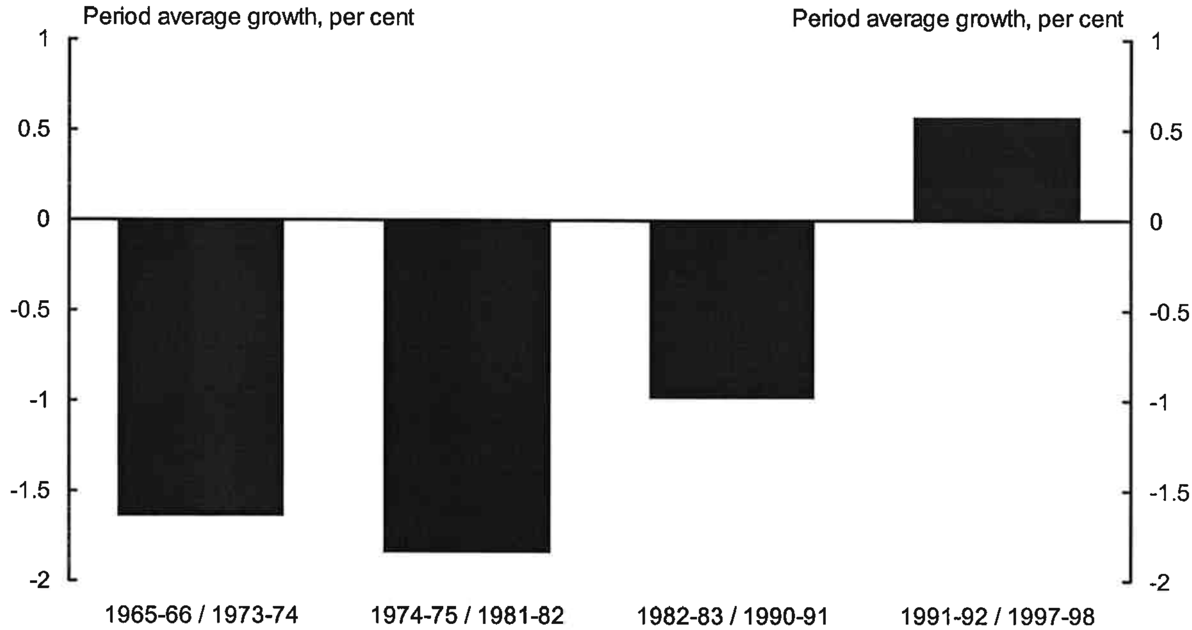


Chart 5:
Capital Productivity in the Market Sector



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